

## Mere Allegations of Defective Construction May Leave Contractors Without Insurance Coverage on a Project

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In 2012, the Ohio Supreme Court decided the case of *Westfield Insurance Company v. Custom Agri Systems, Inc.* (the *Westfield* case). In the *Westfield* case, the Ohio Supreme Court held that construction defects are not “occurrences” as defined in the contractor’s commercial general liability (CGL) policy, and, therefore, do not trigger insurance coverage. Under the *Westfield* case, insurance companies no longer have a duty to defend a construction defect case against the contractor by covering the costs of legal defense, or providing coverage for the alleged loss. The *Westfield* case also has been viewed as negating the applicability of the “Subcontractor Exception” for work performed by subcontractors on the project.

Before the *Westfield* case, the cost to repair and replace defective work generally was not covered by the CGL policy, but damages that resulted from the allegedly defective work often were covered. The insurance company would defend a defective construction case on a “reservation of rights” basis, until a decision was made by the court as to whether the alleged loss was, in fact, defective construction (and not covered by the CGL policy anyway), or another type of loss that would be covered. In addition, general contractors that use subcontractors would have coverage, even if the contractor’s own work is excluded from coverage, by the application of the “Subcontractor Exception.” This exception states that even though damage to “your work” is excluded under the CGL policy, you still may have coverage if the damaged work was performed by a subcontractor.

However, after the *Westfield* case, this all seemed to change, and the change has not been good for contractors. From what is going on in courts across the state, the repercussions of the *Westfield* case are finally being felt by contractors. Many in the construction industry are genuinely concerned over the impact of the *Westfield* case on the future of insurance coverage of contractors in construction disputes, including the long-standing Subcontractor Exception. They should be!

Insurance companies that regularly provide a defense or coverage for contractors on construction disputes are now asking courts, on a routine basis, to allow them out of their duty to defend construction defect cases where a mere allegation of defective construction exists against the contractor, and none has been proven by the injured party. Often, these cases involve allegations of both defective construction and other claims that would otherwise provide coverage. Regardless, courts routinely are allowing more and more insurance companies to escape their duties to defend and provide coverage for damages at the earliest stages of litigation, even though discovery of additional facts as the case progresses could show claims should be covered under the CGL policy.

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What can the contractor, who has paid thousands and thousands of dollars in premiums, do when the insurance company argues there is no coverage? You can fight rather than agree with the insurance company. You do not need to wait and see what happens and a court renders a decision that there is no “occurrence” under the CGL just because a construction defect is alleged. There a number of things you need to do both before you are faced with a defective construction claim, and after you are sued for alleged defective construction.

First, talk to your insurance agent. Understand your CGL policy better -- what is covered and what is not -- and make sure you have the right coverages. Discover which insurance companies treat contractors more fairly than others when dealing with defective construction claims under their CGL policies. That agent also should advise you to establish a quality assurance/quality control program, improve document and record retention, upgrade subcontractor pre-qualification standards, improve training and safety programs and to implement a water intrusion program.

If you use subcontractors on a regular basis, learn about the Subcontractor Exception, and how it may affect coverage under the policy. Many insurance companies issue riders to make sure work done by subcontractors comes within the Subcontractor Exception so that construction defects caused by the subcontractor are covered.

Second, talk to your construction attorney. Make sure your construction attorney is familiar with insurance coverage of construction disputes and how the *Westfield* case has, and more importantly, has *not* changed that scenario. Ask how you can guard against some of the risks of defective construction by reviewing your construction contracts as a preventative measure.

If you are involved in litigation and there is an allegation of defective construction, you can fight it, and your fight will likely be on multiple fronts. Not only will you be fighting against the plaintiff who seeks to hold you liable, you also will be fighting against the insurance company who wishes to neither defend your case nor provide coverage for any of the plaintiff’s claims, even if some claims might be covered.

This fight could well be worth it. For example, in Ohio, the duty to defend is broader than the duty to indemnify. Thus, even if only some of the plaintiff’s claims might be covered by your CGL policy, the insurance company will have a duty to defend against ALL of the claims in the complaint, including those outside the policy’s coverage, such as defective construction.

To fight back, you need to: (1) vigorously contest the allegation of defective construction by engaging an expert witness to render an opinion that the loss is not a result of defective construction; and (2) work with an attorney that understands the nuances of construction law along with insurance law.

As long as contractors build buildings, defective construction claims against contractors, whether valid or not, will be with us. However, in order to decrease some of the many risks on a project, you need to make sure that your response to such a claim provides you with options. Without knowing your options, you may incur considerable attorneys’ fees and damages that should the responsibility of the insurance company.

*For more information on insurance coverage of construction disputes, or advice on other construction law issues, please feel free to contact the following members of our Construction Law Practice Group: [Bryan L. Jeffries](#), chair, Construction Law Practice Group, resident in our Columbus office or [Michael J. Podolsky](#), resident in our Toledo office.*

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